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Supreme Court of the United States

October Term 1946

No. 778

THOMAS FLEXIBLE COUPLING COMPANY, a corporation

Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

AUSTIN F. CANFIELD
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TO THE HONORABLE, CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The petition of Thomas Flexible Coupling Company, a corporation, petitioner in the above entitled proceedings, respectfully represents as follows:

OPINIONS BELOW

The opinions of the United States Tax Court affecting the question herein raised have not yet been reported. The opinion of the United States Circuit Court of Appeals, for the Third Circuit (R.....) has not yet been reported. The judgment below affirms the decision of The United States Tax Court. All pertinent opinions are printed as an Appendix to the petitioner's brief herein.

JURISDICTION

The judgment of the United States Circuit Court of Appeals was entered on August 20, 1946. (R.....) The petition for re-hearing was filed Sept. 4, 1946 and the order denying the same entered October 10, 1946. (R.....) The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U.S.C.A. Sec. 347).

QUESTION PRESENTED

Where a State Court of last resort has declared a royalty agreement between a company and an inventor a valid subsisting contract, entered a money judgment in favor of the inventor for past royalties due and ordered the company to pay future royalties, may the Third Circuit Court of Appeals hold the identical contract invalid and refuse to allow deductions for payments ordered by said judgment of the State Court as necessary business expenses for income tax purposes?

STATUTES INVOLVED

Title 26, Sec. 23, U.S.C.A.

"*Deductions from gross income.* In computing net income there shall be allowed as deductions:

(a) Expenses.

(1) *In general.* All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."

Sec. 34 of the Judiciary Act of 1789; 28 U.S.C.A. sec. 725..

For the Federal Courts, "state laws" are made "the rules of decisions in trial at common law."

STATEMENT OF FACTS

On May 31, 1944 (rehearing denied February 15, 1945) the Tax Court held that Petitioner was liable under a deficiency notice for certain taxes accruing during the years 1939, 1940 and 1941. The Tax Court based its holdings solely upon the premise that a certain royalty payment agreement dated November 26, 1939, between Bertha E. Thomas, Inventor, and Petitioner, relating to patents under which the Petitioner manufactures its only product, was not a valid contract and that all payments made thereunder were not deductible as "ordinary and necessary" business expenses (R. 74).

Pending appeal from the decision of the Tax Court to the Circuit Court of Appeals for the Third Circuit, Petitioner, in order to protect the rights of stockholders, notified Bertha E. Thomas that it would refuse further royalty payments to her and required the repayment to it of the moneys theretofore paid under the royalty agreements which had been held invalid by the Tax Court. Bertha E. Thomas thereupon instituted a suit in the Court of Common Pleas of Warren County, Pennsylvania (having jurisdiction of the Petitioner and the said Bertha E. Thomas) against the Petitioner, seeking a money judgment for royalties payable under said agreement and also for a declaratory judgment to the effect that the agreement of Novmbeer 26, 1939 was a valid and binding agreement between the parties. The Court of Common Pleas gave judgment for the Plaintiff, affirmed the validity of the contract, declared the Plaintiff entitled to receive and retain the royalties originally paid under the agreement, entered judgment for moneys due to date under the royalty agreement and ordered payment of future royalties.

Petitioner, which in the meantime had appealed the decision of the Tax Court to the Third Circuit Court of Ap-

peals, immediately appealed the adverse decision of the Court of Common Pleas of Warren County to the Supreme Court of Pennsylvania. The Supreme Court of Pennsylvania, by its opinion dated March 25, 1946, affirmed the judgment of the Court of Common Pleas of Warren County, held the agreement in question a valid and binding contract, and issued its mandate in conformity therewith.

The proceedings held in the State Courts were brought to the attention of the Circuit Court of Appeals for the Third Circuit in the argument of this case in that Court. The Circuit Court of Appeals disregarded the judgment of the State Court, despite the fact that the State Court interpreted for the first time the relative rights and duties of the respective parties to the contract. The Circuit Court declared the decision of the Pennsylvania Courts invalid, by sustaining the holding of the Tax Court that the contract of 1939 was invalid.

Petitioner, therefore, is filing this, its Petition for Certiorari because it finds itself in the anomalous position of being forced to pay out moneys under a judgment of the State Court on a business contract declared valid by the State Court, invalidated by the Tax Court and the Third Circuit Court of Appeals for income tax purposes.

SPECIFICATIONS OF ERRORS

The Circuit Court of Appeals erred:

1. In holding that the decision of the Supreme Court of Pennsylvania, affirming the validity of a contract between two Pennsylvania residents, was invalid;

2. In refusing to hold that the judgment of the State Court of last resort, that a business contract between two citizens of that State was valid, conclusively determined this question in the Federal Courts;

3. In holding that payments made under said contract and judgment thereon were not deductible as necessary expenses of the company for income tax purposes;

4. In holding that a previous contract requiring inventor to transfer future patents to the company did not carry with it a corresponding obligation to pay royalties provided in that agreement;

5. In holding that the decision of the United States Tax Court that a contract was invalid was a finding of fact not subject to review by the Circuit Court where the only evidence on that point before the Tax Court was the agreements themselves, the payments made thereunder and a single statement in the record that in 1939, the appliance involved (flexible couplings) was not used on automobiles —all uncontroverted items of evidence.

REASONS FOR GRANTING WRIT

1. The Circuit Court has disregarded the rule of law pronounced by this Court that where a question turns upon a property right under the law of the common domicile, the decision of the Court of last resort of the State governs.

2. The Circuit Court of Appeals in refusing to allow tax credits for payments made under a contract between Pennsylvania citizens has in effect declared that contract invalid, whereas the highest Court of the State has declared the contract valid and by its judgment requires money payments in question to be made. Putting it definitely, the money paid under one judgment is held by another judgment to be unnecessarily and illegally paid.

3. The decision of the Circuit Court is in direct conflict with a number of recent decisions of your Court, among which may be cited:

Blair vs *Commissioner*, 300 U. S. 5
Freuler vs *Helvering*, 291 U. S. 45
Sharp vs *Commissioner*, 303 U. S. 624
Stoner vs *New York Life Insurance Company*, 311 U. S. 564

and is in direct conflict with the decision of a number of the Circuit Courts of Appeal, among which may be cited:

Lum vs *Commissioner*, 147 F 2d 356 (decided by the same Court) C.C.A. 3d
Eisenmenger vs *Commissioner*, 145 F 2d 103, C.C.A. 8
Nashville Trust Co. vs *Commissioner*, 136 F 2d 148, C.C.A. 6

PRAYER FOR WRIT

WHEREFORE, your petitioner respectfully prays that a Writ of Certiorari be issued out of and under the seal of your Honorable Court, directed to the United States Circuit Court of Appeals for the Third Circuit, commanding that Court to certify and to send for review and determination on a day certain, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket "No. 9005, October Term, 1945, *Thomas Flexible Coupling Company, Petitions, v. Commissioner of Internal Revenue*, Respondent", and that such judgment of the United States Circuit Court of Appeals for the Third Circuit may be reversed by your Honorable Court, and that your petitioner may have such other and further relief in the premises as to your Honorable Court may seem fit.

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JURISDICTION

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QUESTION PRESENTED

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STATUTES INVOLVED

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"*Deductions from gross income.* In computing net income there shall be allowed as deductions:

(a) Expenses.

(1) *In general.* All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."

Sec. 34 of the Judiciary Act of 1789; 28 U.S.C.A. sec.. 725.. .

For the Federal Courts, "state laws" are made "the rules of decisions in trial at common law."

STATEMENT OF THE CASE

In its recitation of the facts underlying this case, the Circuit Court pointed out that the inventor and payee (Bertha E. Thomas) under the royalty payment agreement under consideration (November 1939) had previously, in 1920, entered into an agreement with the petitioner corporation. The Court noted that under the 1920 agreement the inventor had assigned her patents on flexible couplings "together with all improvements upon the invention" and "all United States Letters patents on future improvements on flexible couplings which may be obtained or acquired by her." In return, Mrs. Thomas on her part received 450 shares of the company stock and *royalties of* 10% *of the gross sales price.* (Br. App. p. 45a.). Years later, the record showing the continued payments of the 10% royalty on the gross sales of the couplings, Mrs. Thomas was issued a new patent—found to be an improvement upon the original inventions—and in November, 1939 she and the petitioner corporation entered into a new agreement whereby she assigned the new patents to the corporation for a cash sum and certain stipulated royalties (which the record shows were in effect less than the original 10% payments). (Br. App. p. 45a). The Tax Court held, and the Circuit Court affirmed, that the payments under the agreement of 1939 were not ordinary and necessary business expenses and therefore not deductible from petitioner's gross income. The lower Courts concluded that the petitioner was under no legal obligation to pay the royalties as there was no consideration for the agreement, Mrs. Thomas having done only that which she was bound to do under the 1920 agreement, which "contract was determined to have been supported by adequate consideration." (Br. App. p. 48a).

After the Tax Court had rendered its decision and the petitioner corporation had refused payment of any further royalties under the agreement, the inventor, Mrs. Thomas,

a Pennsylvania citizen, sued petitioner, a Pennsylvania corporation, in the Pennsylvania courts for a money judgment and a declaratory judgment upon the 1939 agreement. The facts presented before the Pennsylvania court (on bill and answer) were exactly the same as those offered by the petitioner corporation before the Tax Court.[1] (Br. App. p. 47a) The Court of Common Pleas of Pennsylvania granted Mrs. Thomas a money judgment against the corporation, affirmed her right to receive and retain the payment involved in the instant case and declared the 1939 agreement valid and binding. (Br. App. p. 30a). The petitioner corporation appealed this latter decision and the Supreme Court of Pennsylvania affirmed the decision, not however, before requiring notice to be given all stockholders of the proceedings. In its opinion the Supreme Court of Pennsylvania considered the agreement of 1939 alone and in conjunction with the 1920 agreement; it considered the agreement of 1939 under the original facts before the Tax Court and again under the additional facts supplied in the motion for re-hearing filed with the Tax Court. In all of these respects, the Pennsylvania Supreme Court held, the agreement of 1939 was valid and did not lack consideration and that therefore the payments thereunder were necessarily forthcoming. (Br. App. p. 36a-39a)

The Pennsylvania Supreme Court rendered its decision before the hearing of this cause in the Circuit Court. The proceedings in the State Court were brought to the attention of the Circuit Court. At the hearing of the cause, upon questioning by the Court, Government counsel admitted (as he must have) the validity of the 1939 contract

[1] The Circuit Court did not denominate these proceedings collusive, but it did remark on the "radically changed smooth picture given the state tribunal." It evidently overlooked the fact that petitioner was but answering facts already alleged by it under oath in the Tax Court and had naught but to affirm, even had it wished to do otherwise, in answering the complaint of Mrs. Thomas.

was the question of the case; that if the 1939 contract was binding then payments made thereunder were ordinary and necessary business expenses and therefore deductible from gross income. Government counsel further admitted, upon persistent questioning of the Court, that if the 1939 contract were not valid, it was only because of the existence of the 1920 agreement which itself called for a royalty payment of 10%. Upon this, Petitioner argued that the Commissioner should not have its cake and eat it too.—Either allow royalty payments under the 1939 agreement or he should allow royalty payments due under the 1920 agreement.—But the Circuit Court held otherwise. The Circuit Court approved the position of the Tax Court upon the 1939 agreement and disregarded the payments called for under the 1920 agreement (although this latter point was emphatically presented to it again in the petition for rehearing).

The Circuit Court, in its opinion went further and held that the decision of the Pennsylvania Supreme Court "in no way vitiates the Tax Court decision, solidly based on federal tax law . . ."

SPECIFICATIONS OF ERRORS

The Circuit Court of Appeals erred:

1. In holding that the decision of the Supreme Court of Pennsylvania, affirming the validity of a contract between two Pennsylvania residents, was invalid;

2. In refusing to hold that the judgment of the State Court of last resort, that a business contract between two citizens of that State was valid, conclusively determined this question in the Federal Courts;

3. In holding that payments made under said contract and judgment thereon were not deductible as necessary expenses of the company for income tax purposes;

4. In holding that a previous contract requiring inventor to transfer future patents to the company did not carry with it a corresponding obligation to pay royalties provided in that agreement;

5. In holding that the decision of the United States Tax Court that a contract was invalid was a finding of fact not subject to review by the Circuit Court where the only evidence on that point before the Tax Court was the agreements themselves, the payments made thereunder and a single statement in the record that in 1939, the appliance involved (flexible couplings) was not used on automobiles --all uncontroverted items of evidence.

SUMMARY OF ARGUMENT

The judgment of a State Court of last resort, in holding a certain royalty agreement valid, determining that payments made under it were properly made and the property of the inventor, and fully determining the contract rights and obligations of the parties to the contract, is binding not only upon the parties but upon the Commissioner of Internal Revenue and the Federal Courts; and the Commissioner of Internal Revenue may not disallow such payments made under the contract and judgment as not being necessary business expenses for income tax purposes.

ARGUMENT

1 and 2. The Circuit Court of Appeals erred in failing to hold that the judgment of the State Court that the contract was valid conclusively determined this question in the Federal Courts.

The lower courts admittedly had but one question to decide, namely, was there a valid contract (either the 1920 agreement or the 1939 agreement) under which royalty

payments had to be made by the petitioner corporation. (Br. App. p.) The determination of this question was necessarily the determination of a property right. The parties were within the jurisdiction of the Pennsylvania courts, the contracts had been executed in Pennsylvania, the contracts had been performed in Pennsylvania. The courts of Pennsylvania could and did adjudicate this property right. They determined that an "actual controversy" existed (this was a necessary finding under the Pennsylvania Declaratory Judgment Act), awarded a money judgment and decided in a full opinion that the 1939 agreement was valid, considered either in the light of facts presented by the original Tax Court record or under the additional facts presented to the Tax Court in the motion for re-hearing. (Br. App. p. 36a-39a)

The Circuit Court remarked in its opinion—"The contract principles which the Tax Court applied are of course sound Pennsylvania and universal law, but the evidence and particularly the manner of its presentation was far different in the Tax Court than in the Common Pleas." (Br. App. p. 49a). There is no place in the record of this case which gives justification for the statement of the Circuit Court that the evidence in the State court proceedings was different from that of the Tax Court. But even if it were it was the same instrument, the same contract, and therefore the same right of property, that was the subject of adjudication in both jurisdictions. Either there was a contract or there was not a contract. The State court decided that there was a contract, there was a right of property, and this decision should have been conclusive on the Circuit Court. This Court fully enunciated the principle applicable in a case of peculiarly similar facts—*Blair* v. *Commissioner*, 300 U.S. 5. There the question arose as to the validity of a contract, an assignment made under a testamentary

trust. The contract was valid only if the trust was not a spendthrift trust. So in the instant case, the deductions for royalty payments are allowable only if the agreement is valid. Mr. Chief Justice Hughes writing, said:

> "The question of the validity of the assignments is a question of local law. The donor was a resident of Illinois and his disposition of the property in that State was subject to its law. By that law the character of the trust, the nature and extent of the interest of the beneficiary, and the power of the beneficiary to assign that interest in whole or in part, are to be determined. The decision of the state court upon these questions is final . . . It matters not that the decision was by an intermediate appellate court . . . In this instance, it is not necessary to go beyond the obvious point that the decision was in a suit between the trustees and the beneficiary and his assignees, and the decree which was entered in pursuance of the decision determined as between these parties the validity of the particular assignments. Nor is there any basis for a charge that the suit was collusive and the decree inoperative. Freuler v. Helvering, 291 U.S. 45, 78 L.ed. 641. 54 S. Ct. 308). The trustees were entitled to seek the instructions of the court having supervision of the trust. That court entertained the suit and the appellate court, with the first decision of the Circuit Court of Appeals before it, reviewed the decisions of the Supreme Court of the State and reached a deliberate conclusion. To derogate from the authority of that conclusion and of the decree it commanded, so far as the question is one of state law, would be wholly unwarranted in the exercise of federal jurisdiction."

> "In the face of this ruling of the state court it is not open to the Government to argue that the trust was under the Illinois law, a spendthrift trust.' The point of the argument is that, the trust being of that character, the state law barred the voluntary alienation by the beneficiary of his interest. The state court held precisely the contrary. The ruling also determines the validity of the assignment by the beneficiary of

parts of his interest. That question was necessarily presented and expressly decided . . ."

This point was squarely raised in the case of *Vandenbark* v. *Owens-Illinois Glass Co.*, 311 U.S. 538, 85 L.ed. 327. A suit sounding in tort was instituted in the Federal District Court and that court, following the decisions of the state courts, had denied recovery. Pending appeal, the highest court of the state reviewed and reversed the prior controlling decisions. The Circuit Court of Appeals for the Sixth Circuit affirmed the action of the lower court and the Supreme Court granted certiorari. It was contended on behalf of the respondent in the action that the only function of the appellate tribunal was to examine whether, on the record, the lower court was correct in its judgment as of the time of the entry of that judgment. The Supreme Court, denying the validity of this argument, quoted from the case of *United States* v. *The Peggy*, 1 Cranch 103, 2 L.ed., 49, 51, saying:

> " 'It is in general true that the province of an appellate court is only to inquire whether a judgment when rendered was erroneous or not. But if subsequent to the judgment and before the decision of the appellate court, a law intervenes and positively changes the rule which governs, the law must be obeyed, or its obligation denied.' "

Continuing, the Court, after citing instances wherein it had applied the above-quoted principle, stated:

> "These instances indicate that the dominant principle is that nisi prius and appellate tribunals alike should conform their orders to the state law as of the time of the entry. Intervening and conflicting decisions will thus cause the reversal of judgments which were correct when entered."
>
> "Respondent earnestly presses upon us the desirability of applying the rule that appellate courts will review a judgment only to determine whether it was correct when made; that any other review would make

> the federal courts subordinate to state courts and their judgments subject to changes of attitude or membership of state courts, whether that change was normal or induced for the purpose of affecting former federal rulings. While not insensible to possible complications, we are of the view that, *until such time as a case is no longer sub judice, the duty rests upon federal courts to apply state law under the Rules of Decision statute in accordance with the then controlling decision of the highest state court. Any other conclusion would be perpetuate the confusion and injustices arising from inconsistent federal and state interpretations of state law.*" (Italics supplied.)

To like effect, see, *Gulf C. & S. F. R. Co.* v. *Dennis,* 224 U.S. 503, 506-509, 56 L.ed. 860; *Dorchy* v. *Kansas,* 264 U.S. 286, 291, 68 L.ed. 686; *Patterson* v. *Alabama,* 294 U.S. 600, 607, 79 L.ed. 1082; *Huddleston* v. *Dwyer,* 322 U.S. 232, 236, 88 L.ed. 1246 (May, 1944); *Blair* v. *Commissioner, supra; Eisenmenger* v. *Commissioner; West* v. *American Teleph. & Teleg. Co., supra.*

In this connection it is to be further noted that "state laws", which, by Sec. 34 of the Judiciary Act of 1789, 1 Stat at L.92, chap. 20, 28 U.S.C.A., sec. 725, "are made '"the rules of decisions in trial at common law'" define the nature and extent of petitioners' right." * * * "*And the rules of decisions established by judicial decisions of state courts are 'laws' as well as those prescribed by statute.*" (Italics supplied).

West v. *American Tel. & Tel. Co., supra,* citing, *Russell* v. *Todd,* 309 U.S. 280, 289, 84 L.ed. 754, 761, *Erie Railroad Co.* v. *Tompkins,* 304 U.S. 78, 82 L.ed. 1194.

The Blair case is unreversed and not limited by any later decision of this Court. As an answer to petitioner's contention that the Blair case is absolutely determinative upon the Circuit Court in the instant case, that court cited the Lusthaus and Tower cases (Br. App. p.) in neither

of which had a state court rendered a definitive decision on the very point in question, as had the Pennsylvania courts in this case. The Circuit Court further intimated that because of the *Lusthaus* and *Tower* cases the *Blair* case was no longer a controlling decision. (Br. App. 51a)

3. The Circuit Court of Appeals erred in holding that payments which were made under this contract were not deductible as "necessary expenses" of the Company.

The Circuit Court admitted that the Pennsylvania State courts had correctly adjudicated the 1939 agreement to be a valid contract, but stated that the decision "in no way vitiates the Tax Court decision, solidly based on federal tax law, . . ."—"That decision cannot hamper " 'the effective enforcement of a valid federal tax levied against earned income' ".—"In the last analysis, taxability depends upon the application of the Federal criterion.) (Br. App. pp. 49a-51a)

Obviously, the question of the interpretation of the taxing statutes is a Federal one, and the State Court's decisions have no force or effect in considering any question arising under these statutes, unless the application of the taxing statute turns or hinges upon a matter solely within the province of a State court. Thus, the question of how and when a Federal taxing statute is applicable to a particular property right is a Federal one, but the determination of that right of property of citizens within a given state, is vested within the jurisdiction of that state's courts. (*Blair* v. *Commissioner, supra*) So here, we respectfully submit that the Circuit Court should have been highly concerned with the question of property as decided by the Pennsylvania Courts, the question of the validity of contract rights, for the answer to the question of the nature of these property rights was determinative of the Federal question involved. It is true that this ruling of the Pennsylvania courts affects—and we contend con-

trols—the Federal tax liability of the Thomas Flexible Coupling Company, but only because it is a determination of a property right, the validity of a contract which made necessary or unnecessary the business expense claimed. To uphold the position of the Circuit Court of Appeals in the present case, it is necessary to concede to it the right to overturn the decision of the Pennsylvania Supreme Court. For if the decision of the Pennsylvania Supreme Court, that the company must pay the royalties under the contract, is correct, (and it has not been questioned), then the Circuit Court would be in the position of taking A's property to pay B's debt, unless it could sustain its right to reverse the State Court's decision.[2]

The Circuit Court stated that the decision of the Tax Court was "solidly based on federal tax law";—"upon application of the Federal criterion". There is no federal tax law any longer or broader than the words of the statute —"ordinary and necessary business expenses." There is no magic in these words. They are not "Federal words". They do not call into play a "Federal criterion" that is different from any ordinary and everyday usage. (*Peir* v. *Commissioner,* 96 F. 2d 642; *Deputy* v. *DuPont,* 308 U.S. 488, 493). While both the Tax Court and the Circuit Court of Appeals used the above-quoted or similar language to decide the case, they proclaimed that the crux

---

[2] The Supreme Court has been rightly critical of such results:

"The question has practical aspects of great importance in the proper administration of justice in the federal courts. It is inadmissible that there should be one rule of state law for litigants in the state courts and another rule for litigants who bring the same question before the federal courts owing to the circumstance of diversity of citizenship." Fidelity Union Trust Co. v. Field, 311 U. S. 169, 179-180.

"State law (using the term in its broad sense) is to be applied in the federal as well as the state courts and it is the duty of the former in every case to ascertain what the state law is and apply it rather than to prescribe a different rule, however superior it may appear from the viewpoint of 'general law' and however much the state rule may have departed from prior decisions of the federal courts." (Citing Erie R. R. Co. v. Tompkins, supra.) West et al. v. American Tel. & Tel. Co. et al., 311 U. S. 223, 85 L. ed. 139, p. 237.

of the case was the validity of the contract involved. (Br. App. pp. 46a, 48a)

No discussion was had on "ordinary and necessary expenses" — the Federal criterion — other than as those expenses were necessary or unnecessary, depending on the validity or invalidity of the contract. Indeed, during the argument of this case before the Circuit Court, the Court repeatedly queried Government counsel until he admitted that if there were *any* payments required under the instant agreement, or similar valid agreement, those payments would be deemed "necessary" under the statute.

4. In any case, either under the 1920 agreement or under the 1939 agreement, the Circuit Court should have held the royalty payments deductible as ordinary business expenses.

It is not facetious to point out that the respondent "can't have its cake and eat it too". The 1920 agreement had provided for an assignment of patents "and all future improvements" in return for which a royalty of 10% was to be paid. The Tax Court and Circuit Court held that the 1939 contract was invalid and the royalty payments made thereunder disallowed because of the continuing effect of the 1920 agreement. Those courts held that the 1939 agreement conveyed a patent right—the "future improvement" spoken of in the 1920 agreement—and that any payments made therefor were voluntary (not necessary) because the inventor was only doing what she was bound to do.

Assuming that the lower courts were right, that the inventor had only done in 1939 what she was bound by the 1920 agreement to do—what about the royalty payments? What about the royalty payments of 10% provided for in the 1920 agreement? What is sauce for the goose is sauce for the gander. The rule of mutuality decrees that

some royalty payments be made; either the 10% under the 1920 agreement or the amount provided in the 1939 agreement (which worked out to a slightly smaller percentage than 10%). But the result of the decisions of the lower courts is to deny any and all payments of royalties while requiring the assignment of all future patents. As was so ably stated by Mr. Justice Stern in the opinion of the Pennsylvania Supreme Court (Br. App. p. 37a): "It would seem incredible that, in assigning the three original patents to defendant for a royalty fee of ten per cent on the gross sales, and in agreeing to assign all future improvements and all patents that might thereafter be granted to her, the parties contemplated that, after those patents were no longer in force and plaintiff would not be receiving any further royalties therefrom, she would nevertheless remain bound, during the entire balance of her life, to assign to defendant, free of any claim for royalties thereunder, any and all patents for flexible couplings which she might thereafter acquire." This result is all the more surprising when it is recalled that at the time of the argument of the case before the Circuit Court, that Court posed this very question to counsel for the respondent who admitted that if the 1920 agreement is continuing, then there was a continuing obligation to pay the 10% royalty provided for thereunder.

5. The Circuit Court of Appeals erred in holding that the rule announced in the Dobson case precluded its review of the Tax Court decision.

At the very end of its opinion, (Br. App. p. 52a) the Circuit Court stated that the rule announced by this Court in the *Dobson case* (320 U.S. 489) and *Kelley case* (90 L.ed 257, January, 1946), forbade appellate review in the instant cause. There was no elaboration upon this statement.

Appellate review may be secured from the Tax Court's determinations "if the decision of the Board is not in accordance with law" (Revenue Act of 1926, Sec. 1003 (b), 44 Stat. 9, 110).

Upon review by the Circuit Court, this case presented two separate aspects—the correctness of the Tax Court's decision upon its record and the correctness of the Tax Court's decision in the light of the "supervening" (*Blair case, supra*) decision of the State Court. Upon neither of these aspects of the case can it be said that the limitation on review as defined by the statute and as enunciated by this Court in the Dobson and Kelley cases precluded the Circuit Court from disturbing the judgment of the Tax Court. "So to regard them or the statute nullifies the right to review expressly given by Congress. Moreover that view destroys the very uniformity which Dobson sought, transferring the conflict of decision from the Court of Appeals back to the Tax Court, by making the conflicting decisions of its sixteen divisions final. This affords relief to the taxpayer from judicial review and to the courts from judicially reviewing. But it defies Congress' mandate for review and, what is more, perpetuates chaos in the law." (Mr. Justice Rutledge's opinion, Kelley case, *supra*)

There was no issue of fact in the first aspect of the case, the Tax Court's decision upon its record. The only evidence before the Tax Court consisted of the two written agreements, the record of uniform payments thereunder for almost twenty years and a statement that in 1938 the right to apply the patent rights for use on automobiles had no value—all uncontroverted items of evidence. The only ultimate facts were the two written agreements themselves. The only function of the Tax Court was to construe those contracts. The construction of written agreements has been uniformly held by this Court to be a ques-

tion of law. Nor was this part of the case any different when it came to the Circuit Court. It was still a question of law only to decide the legal effect of the two contracts in question.

If there is any doubt regarding the soundness of this position, it is quickly resolved and dissipated when the second aspect of the case is considered—the Tax Court's decision in the light of the "supervening" State Court decision. The controlling question in the case—the validity of a contract—had to be determined by the answer to a conflict of judgments, a conflict of law. So, even assuming that the Tax Court had a maze of debatable facts and agreements constituting "a molecular combination of fact and law which defies separation" (Kelley case, *supra*, footnote 7), it nevertheless made a decision; it decided that the 1939 agreement was not a valid contract. But the Pennsylvania Supreme Court also made a decision; it decided that the 1939 agreement was a valid contract. There was then presented a direct and substantial conflict of law upon a right of property. The Kelley case, relied upon by the Circuit Court in its refusal to disturb the Tax Court's decision, expressly stated that appellate review will be given where a conflict of law is presented. In the majority opinion, Mr. Justice Reed stated:

> "Adequate reason *(for appellate review)* of course exists in situations where true legal questions arise, as in whether an act applies to transfers antecedent to its enactment or to income or estate taxes from trusts or to situations which involve *conflicts of law.*" (Parentheses and italics ours.)

Thus, the very authority relied upon by the Circuit Court to refuse review, compels review.

CONCLUSION

The Circuit Court of Appeals, notwithstanding the judgment of the State Court adjudicating for the first time the relative rights and obligations of the respective parties to the contract, sustained the interpretation of the Tax Court that the parties were not legally bound by the contract of 1939. This conflict of decision between the Supreme Court of Pennsylvania, on a matter of local law binding upon this Petitioner, and the decision of the Circuit Court of Appeals for the Third Circuit, holding that such judgment is not entitled to due credit, compels a double payment by Petitioner (original royalties to Inventor, excess profits and income tax thereon, plus renegotiation determinations to the Government). This situation, from which the Petitioner is powerless to extricate itself, spells financial disaster unless relieved by this Court.

AUSTIN F. CANFIELD
WILLIAM T. HANNAN
Attorneys for petitioner.

APPENDIX

THE TAX COURT OF THE UNITED STATES

THOMAS FLEXIBLE COUPLING CO.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket Nos. 110799, 257

Robert Ash, Esq., for the petitioner.

Jonas M. Smith, Esq., for the respondent.

Memorandum Findings Of Fact And Opinion

In docket No. 110799 the respondent has determined a deficiency of $2,175.94 in petitioner's "excess profits liability on navy contracts and/or subcontracts under section 3 of the Act of March 27, 1934 (48 Stat. 505), as amended * * *" (Vinson Act) for the year ended December 31, 1939.

In docket No. 257 the respondent has determined the following deficiencies:

Year	*Tax*	*Amount*
1940	Income	$ 8,951.72
1940	Declared value excess-profits	3,534.06
1940	Excess-profits	4,137.38
1941	Income	8,055.96
1941	Excess-profits	44,134.60

The sole issue presented herein is whether petitioner was entitled to deduct from its gross income certain amounts paid as "royalties" to Bertha E. Thomas.

Findings Of Fact

Petitioner is a Pennsylvania corporation, and filed its report of profit on Navy contracts for 1939 and its income and excess-profits tax returns for 1940 and 1941 with the collector of internal revenue for the twenty-third district of Pennsylvania at Pittsburgh.

It is engaged in the business of manufacturing and selling flexible couplings and, in some instances, the component parts of such couplings.

This coupling is a device for connecting a driving shaft with a driven shaft in such a manner as to compensate for angular and parallel misalignment and provide free and float without setting up cross pull or end thrust on the bearings. The Thomas coupling is the only flexible coupling which will support weight while transmitting torque and at the same time provide flexibility.

The petitioner corporation was organized in 1917. Its president is Millard T. Thomas, who has been engaged in the coupling business since 1914.

Bertha E. Thomas, wife of Millard T. Thomas, secured on the dates indicated below three patents, on flexible couplings, numbered as follows:

Patent No. 1,323,423—December 2, 1919
Patent No. 1,325,545—December 23, 1919
Patent No. 1,326,993—January 6, 1920

At the time of the third annual meeting of its stockholders, held January 6, 1920, Millard T. Thomas owned 325 and Bertha E. Thomas 25 shares of the total of 492 represented at the meeting. The president of the corporation announced at that meeting that Mrs. Thomas declined to renew the manufacturing agreement in force during 1919, under Patent No. 1,325,545 and had made the following proposition:

Proposition by Bertha E. Thomas to the Thomas Flexible Coupling Company, viz: That for and in consideration of four hundred and fifty (450) shares of the capital stock of said corporation, and the payment to her quarterly of a royalty fee of ten per cent (10%) of the total amount of the gross sales of said Simplex coupling during the life of the patent, she will assign to said corporation U. S. Letters Patent number 1,325,545, issued to her on December 23, 1919, for Flexible Couplings, saving and reserving to herself, her executors, administrators and assigns, the exclusive right, under said patent, to manufacture and sell flexible couplings for use on motor vehicles of any description. A further condition of the assignment of said patent is that in the event of the Thomas Flexible Coupling Company increasing its capital stock at any time, said Bertha E. Thomas shall participate in such increase to the extent of receiving without further consideration fifty per cent (50%) of the increase of the capital stock.

This proposition was accepted by the corporation at the same meeting in the following language:

Resolved by the stockholders of the Thomas Flexible Coupling Company that the proposition of Bertha E. Thomas just read be accepted and recorded in the minutes of this meeting; and that the Board of Directors be authorized hereby to purchase said U. S. Patent upon the conditions named in said proposition, and to issue four hundred and fifty shares of the capital stock of said corporation to said Bertha E. Thomas, and to pay to her ten per cent (10%) of the total amount of the gross sales of said coupling during the life of said patent, with the understanding and agreement that in the event of any further increase in the capital stock of said corporation she shall receive without further consideration fifty per cent of such increase, in payment for the assignment from said Bertha E. Thomas to said Corporation.

On March 20, 1920, the following contract was entered into between the petitioner and Bertha E. Thomas with reference to the other two patents referred to above:

THIS AGREEMENT, made this 20th day of March, 1920, between the Thomas Flexible Coupling Company of Warren, Pennsylvania, a corporation organized under the state of Pennsylvania, party of the first part, and Bertha E. Thomas, of Erie, Pennsylvania, party of the second part.

WITNESSETH: That the party of the second part having assigned to the party of the first part all of her rights, title and interest in and to United States Letters Patent No. 1,323,423 dated December 2, 1919, and No. 1,326,993, dated January 6, 1920, together with all improvements upon the invention there described and claimed; the party of the first part for and in consideration of the sum of one dollar and certain other good and valuable considerations, hereby grants to the party of the second part, her heirs and assigns, the sole and exclusive right to make and sell and to have made and sell under the aforesaid Letters Patents and all improvements on said patents which she may make or hereafter acquire on flexible couplings to be used in connection with automobiles, trucks and tractors, territory not limited.

The party of the first part also grants to the party of the second part a sole and exclusive license, territory not limited, to manufacture and sell or to have manufactured and sell flexible couplings under any patents which it may now own or hereafter acquire, to be used in connection with and on automobiles, trucks and tractors only, the party of the first part reserving the right to manufacture and sell or to have manufactured and sell flexible couplings for all purposes other than for application to automobiles, trucks and tractors.

The party of the first part also grants unto the said party of the second part the right to grant and sell sublicenses thereunder to manufacture and sell flexible couplings to be used in connection with or on automobiles, trucks and tractors without the consent of the party of the first part.

This contract made in duplicate between the party of the first part and the party of the second part for the mutual consideration expressed conveys to the party of the second part an exclusive license to manufacture and sell or have manufactured and sell flexible couplings to be used in connection with or on automobiles, trucks and tractors only, in consideration of the assignment by the party of the second part of all United States Letters Patents she now owns on flexible couplings and which may be hereafter granted to her and all United States Letters Patents on future improvements on flexible couplings which may be obtained or acquired by her.

IN WITNESS WHEREOF, the parties of the first and second part have respectively set their hands and seals this *twentieth* day of *March,* 1920.

The 450 shares of stock provided for at the annual meeting held January 6, 1920, were issued to Mrs. Thomas, after the authorized capital of the corporation was insreased for that purpose and payments, denominated "royalties", amounting to ten percent of the gross sales price, were thereafter made to Mrs. Thomas throughout the life of the patent referred to in this agreement, and after its expiration until early in 1939, after which a different arrangement was made, which will be set forth later in these findings.

On September 2, 1937, Mrs. Thomas applied for a patent for an improvement in flexible couplings, consisting of (1) the arrangement of the metal discs in the flexible laminated ring in a flexible coupling so that the grain of

the metal in adjacent discs is in angular relation and at a predetermined angle, and (2) an improvement in the design of washers and bosses used in flexible couplings. This invention was assigned by Mrs. Thomas to the petitioner and the patent therefor was issued to petitioner on December 5, 1939, numbered 2,182,711.

On August 8, 1939, Mrs. Thomas applied for a patent relating to an emergency support for flexible couplings. The patent was granted August 8, 1941, and is number 2,251,722.

These two inventions were assigned by the same instrument in writing, dated October 26, 1939, recorded in the United States Patent Office on October 27, 1939, which reads as follows:

WHEREAS, I BERTHA E. THOMAS, of Warren, County of Warren and State of Pennsylvania, have invented certain new and useful improvements in flexible couplings for which I have filed applications for Letters Patents of the United States, described as follows:-

FLEXIBLE COUPLINGS, Serial No. 162,205

Filed September 2, 1937

Allowed October 10, 1939

EMERGENCY SUPPORTS FOR FLEXIBLE COUPLINGS

Serial No. 289,058, filed August 8, 1939

AND WHEREAS, THOMAS FLEXIBLE COUPLING COMPANY, a corporation organized under the laws of the State of Pennsylvania and domiciled and having its post office address at said Warren, is desirous of acquiring the entire interest in and to the said inventions and applications, and in and to any patent or patents to be obtained thereon:-

NOW THEREFORE, be it known that for and in consideration of the sum of Five Dollars ($5.00), the receipt

of which is hereby acknowledged, and other good and valuable considerations, I, the said BERTHA E. THOMAS, by these presents do sell, assign and transfer unto the said THOMAS FLEXIBLE COUPLING COMPANY, its legal representatives, successors and assigns, the full and exclusive right for the territory of the United States of America and for all foreign countries, in and to the said inventions in Flexible Couplings, and in and to the applications filed as aforesaid September 2, 1937, Serial No. 162,205 and August 8, 1939, Serial No. 289,058, and in and to any patent or patents issued therefor and thereon, together with all divisions, renewals, continuations and reissues thereof; said inventions, applications and Letters Patents to be held and enjoyed by the said THOMAS FLEXIBLE COUPLING COMPANY, for its own use and behoof, and for its legal representatives, successors and assigns, to the full end of the terms for which Letters Patents may be granted as fully and entirely as the same would have been held by me had this assignment and sale not been made.

AND I FURTHER STIPULATE AND AGREE that I will at the request and charge of the said THOMAS FLEXIBLE COUPLING COMPANY, its legal representatives, successors and assigns, do all other lawful and just acts that may be or become necessary for the purpose of obtaining Letters Patents of the United States as aforesaid and to perfect its title thereto.

Executed this 26th day of *October*, 1939.

On November 26, 1939, Mrs. Thomas and the petitioner executed the following contract:

THIS AGREEMENT made and entered into this 26 day of *November*, 1939, by and between the Thomas Flexible Coupling Company, a corporation existing under and by virtue of the laws of the State of Pennsylvania, having

its principal place of business at 1200 Main Avenue, Warren, Pennsylvania, hereinafter referred to as "Company" and Bertha E. Thomas of No. 9 Second Avenue, Warren, Pennsylvania, thereinafter referred to as "Inventor".

WITNESSETH, THAT:

WHEREAS, "Inventor" has conceived of and produced inventions relating to flexible couplings, as more particularly set forth in applications filed in the United States Patent Office and identified as follows:-

Flexible Couplings
Serial No. 162,205
Filed September 2, 1937
Allowed October 10, 1939
Emergency Supports for Flexible Couplings
Serial No. 289,058
Filed August 8, 1939

WHEREAS, "Inventor" has, or may have, other new and useful improvements and ideas relating to flexible couplings.

WHEREAS, "Company" is desirous of securing assignment of the inventions and proprietary rights of "Inventor" in and to the above identified applications for United States patents, and in and to the inventions set forth therein, and to any inventions relating to flexible couplings which the "Inventor" may hereafter make.

NOW, THEREFORE, for and in consideration of the sum of Three Thousand Five Hundred Dollars ($3500.00) paid by "Company" to "Inventor", receipt whereof is hereby acknowledged by "Inventor" and other good and valuable considerations hereinafter mentioned, it is mutually understood and agreed as follows:-

Article 1. "Inventor" agrees at "Company's" request, to execute in "Company's" favor, all papers which may

be necessary for the transfer, by complete assignment, of all of "Inventor's" proprietary rights in and to the above identified applications for letters patent in the United States, and of all proprietary rights in and to any inventions which "Inventor" may now have or make in the future relating to flexible couplings, on the terms and under the conditions as hereinafter provided.

Article 2. "Inventor" agrees at "Company's" request, to make and execute and have filed in the United States Patent Office, and in the respective offices of foreign countries, applications for patents on such of "Inventor's" inventions relating to flexible couplings, as may be deemed advisable by "Company."

Article 3. "Company" agrees to keep a true and accurate record of the exact number of flexible couplings and discs manufactured and sold by it, together with the invoicing price of all such couplings and discs as are sold, and to render to "Inventor" monthly reports (under oath if requested by "Inventor") setting forth the number of flexible couplings and discs sold by it embodying any of "Inventor's" inventions. "Company" hereby agrees to permit "Inventor", or her duly authorized and accredited representative, to examine its records at all reasonable times to verify such reports.

Article 4. "Company" shall pay to "Inventor" a royalty in amount of 20% of the invoicing price of all coupling plete couplings sold by "Company", or by any of "Company's" licensees; said royalty to be payable monthly in conformity to the reports set forth in the immediately preceding article.

Article 5. "Company" shall pay to "Inventor" a royalty in amount of 20% of the invoicing price of all coupling discs based on the repair price list of discs ordered as repair parts, whether such discs are manufactured by "Company", or "Company's" licensees.

Article 6. "Company" shall pay to "Inventor" a royalty in amount of 20% of the invoicing price of all coupling discs sold separately, where the customer makes the other parts of the coupling, whether such discs are manufactured by "Company", or "Company's" licenses.

Article 7. The minimum royalty to be payable monthly in conformity with the immediately preceding Articles 4, 5, and 6 shall not be less than Two Hundred Fifty Dollars ($250.00) and in default thereof the "Inventor" may at her election cancel this agreement.

Article 8. This agreement shall become effective as of the eighth day of May, 1939, which is the first date on which the United States patent Examiner held that the claims covering discs in application Serial No. 162,205 appeared to be allowable, and shall continue in full force and effect until the expiration of any United States patent which may issue on the aforesaid application Serial No. 162,205.

Article 9. "Inventor" agrees to promptly disclose to "Company" any and all inventions made or acquired by "Inventor" during the life of this agreement with respect to flexible couplings, and agrees to make a prompt and complete assignment to "Company" of her entire title, right and interest in and to any inventions or patentable improvements which she may make or acquire in the future with respect to flexible couplings. Provided however, that "Inventor" will be adequately compensated for any such inventions which "Company" may at its discretion acquire from "Inventor".

Article 10. "Inventor" agrees to assign to "Company" her entire title, right and interest in and to any pending applications, patents, or applications which may be filed in the future and in and to any inventions therein set forth which relate in any way to flexible couplings.

Article 11. "Inventor" agrees that "Company" shall have the complete control and regulation as to filing and prosecution of application for patents in the United States and foreign countries, upon any of "Inventor's" present or future inventions relating to flexible couplings.

Article 12. "Company" agrees to assume all financial expenditures necessary to prepare and prosecute "Inventor's" patent applications as herein outlined, and agrees to bear all expenses incidental to the upkeep of patent applications and patents issued thereon, such as payment of Government taxes, fees, maintenance and normal working expenses.

Article 13. It is understood that "Company" shall have exclusive control of the prosecution of suits against infringers and shall be entitled to retain all proceeds as a result of such suits, subject to payment of royalties in proportion to the royalties herein outlined.

IN WITNESS WHEREOF, the parties hereto have, on the date first above written, caused these presents to be signed by "Inventor" personally, and by "Company" in its corporate name by its duly authorized officer and its corporate seal affixed hereunto.

On December 5, 1939, and August 5, 1941, Patents No. 2,182,711 and No. 2,251,722 were issued to Thomas Flexible Coupling Company pursuant to the assignment set out above. Any license to make or sell under letters patents on flexible couplings to be used in connection with automobiles, trucks and tractors was without value on October 26, 1939 and November 26, 1939.

The method of dialing the discs, as covered by Patent No. 2,182,711 has the advantage of equalizing the flexibility and torsional strength of the ring, increasing the impact strength, torque capacity and resistance to fatigue. Engineers recognize the advantage of the dialing arrange-

ment of the discs, and their approval helps to sell the product. The Thomas method of disc assembly is used on all couplings made by petitioner, the emergency support, covered by Patent No. 2,251,722, is not used very often, but has important advantages where its use is indicated. The latter is designed to prevent damage to the generator in the event of failure of the coupling.

The payments made, after the execution of the contract of November 26, 1939, were made in accordance with its terms, and the amounts so paid and which are here in controversy are $4,672 in 1939, $37,151.04 in 1940 and $65,672.10 in 1941.

Opinion

KERN, *Judge*: Respondent's primary contention is to the following effect: In January 1920 Bertha E. Thomas sold and assigned to petitioner Patent No. 1,325,545 which had to do with flexible couplings, reserving to herself the right, under the patent, to manufacture and sell flexible couplings for use on motor vehicles. In consideration therefor petitioner issued to Mrs. Thomas 450 shares of its stock, and agreed to pay her as "royalties" 10 percent of the gross sales of its products. At some time prior to March 20, 1920, Bertha E. Thomas had assigned to petitioner patents No. 1,323,423 and No. 1,326,993, which also had to do with couplings, but had not reserved to herself the right to manufacture and sell under these patents couplings for use in motor vehicles as she had done in her assignment of January 1920. On March 20, 1920, Bertha Thomas and petitioner entered into an agreement whereby petitioner, then the owner of the patents referrd to, grantd to Bertha Thomas the "exclusive license to manufacture and sell * * * flexible couplings to be used in connection with or on automobiles, trucks and tractors only, in consideration of the assignment by (Bertha Thomas) of all United States Letters Patents she now owns on

flexible couplings and which may be hereafter granted to her and all United States Letters Patents on future improvements on flexible couplings which may be obtained or acquired by her." The two patents directly involved in this proceeding were applied for by Bertha Thomas, and were issued on December 5, 1939, and August 5, 1941, to petitioner pursuant to Bertha's prior assignment hereinafter mentioned, the first being Patent No. 2,182,711 and the second being Patent No. 2,251,722. Applications for these patents were filed on September 2, 1937, and August 8, 1939, respectively. They both covered improvements in flexible couplings. On October 26, 1939, Bertha Thomas "for and in consideration of the sum of Five Dollars '($5.00) * * * and other good and valuable consideration" assigned to petitioner her rights in and to the inventions covered by the applications and any patents issued therefor and thereon. This assignment was recorded in the United States Patent Office on October 27, 1939. Thus, when petitioner and Bertha Thomas executed the agreement of November 26, 1939, providing for the payment of the "royalties" here in question in return for the assignment to petitioner of Bertha's rights to the patents applied for by her and any patents issued therefor and thereon, petitioner already was the owner of these patent rights by virtue of the assignment of October 26, 1939, and was entitled to the assignment of the patents here involved by reason of its contract with Bertha executed under date of March 20, 1920, her obligation, therein set out, to assign all patents on future improvements on flexible couplings which might be acquired by her being supported by the consideration recited in the 1920 agreement. Therefore, being already the owner of all patent rights of Bertha in and to the patents applied for on September 2, 1937, and August 8, 1939, and being entitled thereto by the contract of March 20, 1920, petitioner was under no legal obligation to make additional payments

therefor, and consequently, the payments provided for in the contract of November 26, 1839, and made purportedly pursuant thereto were not ordinary and necessary business expenses, and therefore were not deductible from petitioner's gross income.

We agree with this contention. Petitioner was entitled to "all United States Letters Patents on future improvements on flexible couplings which may be obtained or acquired by (Bertha E. Thomas)", by the terms of the March 20, 1920, contract. This contract was supported by adequate consideration. In addition to the consideration recited in the contract Bertha E. Thomas was a large stockholder of petitioner and was interested in the profits arising from the business in which the inventions were used. As was stated by Mr. Justice Bradley in *Aspinwall Manufacturing Co. v. Gill,* 32 Fed. 697:

* * * where a man purchases a particular machine secured by a patent, and open to an indefinite line of improvements, it is often of great consequence to him that he should have the benefit of any future improvements that may be made to it. Without that, the whole value of the thing may be taken away from him the next day. A better machine might be made by the inventor, and sold to another party, which would make the machine acquired by the first purchaser entirely useless. These things happen every day. And hence it has become the practice, in many cases, to stipulate for all future improvements that may be made by the same inventor upon any particular machine which he induces a party to purchase from him, sometimes by way of license to use such improvements, and sometimes by way of purchase and ownership thereof. Where the inventor is connected in business with the party making such stipulation, or is interested in the profits arising from the business in which the invention is used, the arrangement seems to be altogether unobjectionable.

But such a connection or interest does not seem to be necessary to the validity of such bargains. If based upon a valuable consideration, they are sustained as collateral or incidental stipulations connected with the conveyance of a principal subject.

See also *Dry Ice Corporation v. Josephson,* 43 Fed. (2d) 408,416. There is no question but that the two patents directly involved here and for which the purported royalties were paid, the deduction of which is here in question, were on improvements in flexible couplings, and thus come squarely within the terms of the March 20, 1920 agreement. Likewise, there is no question but that the agreement of Bertha E. Thomas to assign patents on future improvements on flexible couplings was supported by adequate consideration, or that Bertha E. Thomas was a large stockholder of petitioner. Thus, petitioner was entitled without further payment to any patents which might be issued to Bertha on any such improvements. *Dry Ice Corporation v. Josephson, supra; Conway v. White,* 9 Fed. (2d) 863; *Piggly Wiggly Corporation v. Saunders,* 1 Fed. (2d) 572; *Fairchild v. Dement,* 164 Fed. 200; *Goodyear Tire & Rubber Co. v. Miller,* 22 Fed. (2d) 353.

Since petitioner was entitled to the patents here in question without further payment, and the patents were already assigned to it under date of October 26, 1939, the petitioner was under no legal obligation to make the payments to Bertha E. Thomas as set out in the agreement of November 26, 1939. Voluntary payments made in the absence of an existing obligation are not "ordinary and necessary expenses paid or incurred * * * in carrying on a trade or business." See Mertens, Law of Federal Income Taxation, §25.12 and cases cited. The promise to do something which the party making the promise is already legally obligated to do is not good consideration. Williston on Contract, Rev. Ed. Vol. 1, Sec. 130; 17 Corpus Juris Secundus, Sec. 110. Therefore, the promise to make pay-

ments executed in consideration of the promisee's agreement to do something which he is already legally obligated to do or which he has already done pursuant to a pre-existing legal obligation, is not a valid legal obligation and the payments, if made, are not in the usual case ordinary and necessary business expenses. Here petitioner was under no legal obligation to make the payments in question and nothing is shown which would indicate some exceptional business necessity to make the payments. We conclude that the payments of so-called "royalties" by petitioner to Bertha E. Thomas during the taxable years were not deductible.

One of the questions argued extensively by both parties is whether the payments to Bertha E. Thomas as "royalties" were reasonable in amount. In view of our conclusion that they were not ordinary and necessary business expenses and therefore not deductible, it is immaterial whether they were reasonable or unreasonable in amount.

Decision will be entered for the respondent.

Enter:

Entered May 31, 1944

Docket No. 110799

Decision

Pursuant to the determination of the Court, as set forth in its Memorandum Findings of Fact and Opinion entered May 31, 1944, it is

ORDERED AND DECIDED: That there is an excess profits tax liability under Section 3 of the Vinson Act for the calendar year 1939, in the amount of $2,175.94.

Enter: (Signed) JOHN W. KERN,
Judge

ENTERED MAY 31, 1944

COPIES SERVED ON BOTH PARTIES

Docket No. 257

Decision

Pursuant to the determination of the Court, as set forth in its Memorandum Findings of Fact and Opinion, entered May 31, 1944, it is

ORDERED and DECIDED: That there are deficiencies in tax, as follows:

Year	*Tax*	*Amount*
1940	Income	$ 8,951.72
1940	Declared value excess-profits	3,534.06
1940	Excess-profits	4,137.38
1941	Income	8,055.96
1941	Excess-profits	44,134.60

(s) JOHN W. KERN

ENTERED MAY 31, 1944

Memorandum Sur Order Denying Petitioner's Motion to Vacate Opinion and Decisions and for Rehearing and Reconsideration

KERN, J. Because of the earnestness with which the motion to vacate our opinion and findings and for a rehearing has been urged by petitioner's counsel, and because of the importance of this case to petitioner, not only in regard to tax consequences, but also in regard to the renegotiation of its war contracts, we have thought it appropriate to indicate briefly our reasons for denying the motion.

The contentions of petitioner may be summarized as follows: (1) There is newly discovered evidence to the effect that an oral agreement between Mr. Thomas, acting on behalf of petitioner, and Bertha E. Thomas superseded the written contract of March 20, 1920 which was rescinded; by the terms of this oral contract Bertha E. Thomas was no longer obligated to assign to petitioner any patents which might thereafter be granted to her and any patents on future improvements on flexible couplings; and therefore the assignments of the patents in 1939, being assignments to which petitioner was not already legally entitled, constituted consideration for the agreement of petitioner to pay to Bertha E. Thomas the royalties in question; (2) There is newly discovered evidence to the effect that the assignments of the patents on October 26, 1939, were made pursuant to a contract entered into between petitioner and Bertha E. Thomas in January 1939; the contract of November 26, 1939, was merely a formal confirmation of the previously existing contract; and, therefore, it can not be said that petitioner was already the owner of these patents when it contracted to pay the royalties here in issue; and (3), There is evidence now available to demonstrate that we erred in our finding that any license to make or sell flexible couplings covered

by patents owned or to be acquired by petitioner for use in connection with automobiles, trucks and tractors was without value in 1939; the record does not support such a finding; the right to a license for such uses was acquired by Bertha E. Thomas under the contract of March 20, 1920; this right was, in effect, relinquished to petitioner by her by the contract of November 26, 1939; and this constituted a consideration for the contract obligating petitioner to pay the royalties here in issue.

Petitioner's first contention is wholly without merit. Under no circumstances can the evidence concerning an oral contract of January 1930 be considered as newly discovered evidence. One of the parties to such an alleged contract, the president of petitioner and the husband of Bertha E. Thomas, testified extensively at the hearing herein, made no reference to such a contract, and his testimony was, in fact, inferentially inconsistent with the existence of such a contract. (R. p. 341)

The second contention of petitioner would merit our consideration if it would in any way affect our decision of this case. However, as we shall later point out, it would not affect our decision, and we therefore consider it unnecessary to discuss it on its merits.

The third contention of petitioner relates to the value, if any, to be given the right granted to Bertha E. Thomas by the contract of March 20, 1920, to licenses under the patents covered thereby and under future patents, in connection with automobiles, trucks and tractors, the petitioner arguing that these rights were valuable in 1939, that Bertha E. Thomas relinquished these rights to petitioner by the contract of November 26, 1939, that the relinquishment of these rights constituted consideration for petitioner's obligation to pay the royalties in question, and that therefore the payments of these royalties were

ordinary and necessary business expenses deductible from gross income.

We made our finding that the right to such licenses was without value in 1939 because of the testimony on direct examination of petitioner's president (R. 341) as follows:

Q. Has the Thomas coupling ever been successfully adapted to the use on automobiles? A. No, Sir.

This categorical testimony is not questioned, in any way, by any other part of the record, and, in our opinion, supports our finding. Affidavits have since been filed by petitioner which support petitioner's present contention that the rights to licenses under patents covering the flexible coupling had a substantial value. The affidavits do not refer to newly discovered evidence. However, even assuming *arguendo* that we erred in making the finding above referred to from the record before us, or that the evidence to the contrary contained in the affidavits was newly discovered, we would still reach the same result as we did in our decision already entered herein. In order for the petitioner's argument on this point to prevail, not only must the rights of Bertha E. Thomas to the licenses in question have been valuable in 1939, but they must also have been relinquished to petitioner in order to establish consideration for petitioner's payment of royalties. The contracts and assignment of 1939 make no reference to a relinquishment by her of the right to licenses granted to her by the contract of March 20, 1920. Parenthetically the absence of any such reference is consistent with the testimony of petitioner's president that the Thomas Coupling had never been adapted to use on automobiles. It was not worth mentioning in 1939. Nothing in the contracts of 1939 was inconsistent with the retention by Bertha E. Thomas of her rights to licenses under the patents assigned. She was under obligation to as-

sign to petitioner the patents in question, and the petitioner had agreed that she should be entitled to certain licenses. "As between the parties, an agreement to give a license is as effective as a formal license, if it is shown that the prospective licensee has performed the conditions specified in the contract." Patent Assignments and Licenses, Ellis, p. 234. Upon making the assignment of the patents in 1939, Bertha E. Thomas became entitled to the licenses agreed upon by the contract of 1920, and nothing appears in the contracts of 1939 inconsistent with her rights to such licenses. Therefore, even if we assume to the contrary of what we still consider as established by the record—that the rights to licenses acquired by Bertha E. Thomas in 1920 were of value in 1939, we are of the opinion that they were not relinquished by her to petitioner by the contracts of 1939 and can not constitute a consideration for petitioner's agreement to pay to royalties in question.

Our views on the third contention of petitioner which we have just discussed make irrelevant petitioner's second contention. If, by the contracts of 1939, petitioner acquired nothing to which it was not already entitled, it is immaterial that one of them antedated the assignments of October 26, 1939.

Petitioner has assigned other errors in suport of its motion, all of which we have considered. In our opinion, petitioner's contentions with regard thereto are without merit and any discussion of them in this memorandum is unnecessary. The principal points urged by petitioner have been discussed above.

It should be emphasized in his memorandum that the hearings in his case were held for three days in New York City and one day in Washington. The petitioner was represented by experienced counsel and every opportunity was given for adducing every relevant fact. After our decision was entered in this case, petitioner employed new

counsel who prepared and filed the motion before us. In effect they now desire to re-try the case. We are of the opinion that petitioner has not shown that it is entitled to a second trial.

A large part of petitioner's argument was to the effect that regardless of technical considerations concerning newly discovered evidence we should grant the motion in order to do justice and equity, that it could be granted in our sound discretion, and that this discretion should be broadly exercised. Petitioner points out that if it is called upon now to pay taxes determined to be due for the taxable year, and taxes which will be due for other years if respondent's determination is upheld, and if adjustments are made in its earnings under certain war contracts (a matter which we are in no way here concerned), it will be in a serious financial condition. Frequently the payment of taxes, particularly when not anticipated by the taxpayer, results in financial discomfort and, at times, in disaster. However, the question in cases before this tribunal has always been whether the respondent erred in his determination that there was a deficiency in a petitioner's tax, and this question must be decided according to the provisions of the appropriate revenue Act and not according to our own concepts of fiscal equity. We have decided in this case that the respondent did not err in his determination. No error has been shown in this decision on the record before us and no facts which we could properly consider have been called to our attention by affidavit which would cause us to change our decision. Therefore, we must consider the situation as one in which the petitioner owes a tax but contends that it would be disastrous to it if it were called upon to pay it. Such a contention can not properly be made to this tribunal.

We conclude that petitioner was afforded a full and fair trial at which it was represented by experienced counsel,

that no newly discovered evidence is shown by the affidavits accompanying the motion before us which would affect our decision, that no such equitable consideration is involved herein as would warrant our deviation from a policy against having more than one trial of one case, and that no error was committed upon the record before us.

The motion is accordingly denied.

IN THE COURT OF COMMON PLEAS
OF WARREN COUNTY

No. 23 June Term, 1945

Bertha E. Thomas

vs.

Thomas Flexible Coupling Company

OPINION

There was issued to the plaintiff, Bertha E. Thomas, personally, three valuable patents concerning the art of flexible couplings on December 2, 1919, U. S. Patent No. 1,323,423; on December 23, 1919, U. S. Patent No. 1,325,545; and on January 6, 1920, U. S. Patent No. 1,326,993, all of which the defendant desired to use under contract with the plaintiff. Negotiations were had which resulted in the submission in writing to the Company a proposition and an acceptance in writing by the Company, said transaction being properly entered on the minutes of the Corporation-defendant. The parties entered into a contract covering the same subject on March 20, 1920; however, this contract was incomplete in the expression of the entire transaction. The intention of the parties is clear if the written proposals of January 6, 1920 are read together with the written contract of March 20, 1920.

By this agreement the owner of the patents assigned to the Company "All of her right, title and interest in and

to" the patents "together with all improvements upon the invention there described and claimed". Then the Corporation gave to the owner "the sole and exclusive right to make and sell under the aforesaid letters patent and all improvements on said patents which she may make or hereafter acquire on flexible couplings to be used in connection with automobiles, trucks and tractors, territory unlimited." It is, therefore, apparent that the Corporation had the right to use the patents in any and all fields, except the automotive field, which was expressly reserved to the owner.

The owner received 450 shares of the capital stock of the Corporation, and "fifty per cent of the increase of the capital stock", if and when made. Then the owner would receive "ten per cent (10%) of the total amount of gross sales of said Simplex coupling during the life of the patent.

This agreement is clear and unambiguous, and was executed by the parties over a period of years until 1929. A financial crisis of the Company required an issue of additional capital stock for sale to the public so that funds could be raised, and a proposed plant built in Warren, Pennsylvania. The Company being mindful of the provisions of the existing contract approached the plaintiff and asked her to waive her right to one-half of the increase of the capital stock, for, otherwise, the progress of the Company would be blocked to the disadvantage of all. After some negotiations the plaintiff agred to waive the provisions concerning the increase of capital stock, and in addition thereto purchased fifty shares of stock in the Corporation at one hundred dollars per share.

The Company progressed and prospered for many years after this crisis. During the years 1934 to 1937 certain deficiencies appeared in the coupling due to the greatly increased speed and power of engines generally. The

plaintiff filed an application for a patent, admittedly an improvement on flexible couplings, which protected the making of a combination of discs, cross-grained, resulting in a flexible coupling of unprecedented strength. This patent was resisted by the government, but was finally allowed to the plaintiff on December 5, 1939, U. S. Patent No. 2,182,711, Serial No. 162,205. A supplementary patent which concerned emergency supports was also allowed to the plaintiff on August 8, 1941, U. S. Patent No. 2,251,722, Serial No. 289,058.

During this period experimentation was being made in the automotive field, with the full knowledge of both parties, but without any further agreement being made covering this subject matter. The experimentation showed signs of commercial success, and in fact it had progressed to such an extent that actual value in the automotive field had been created in flexible couplings.

Under these changed conditions the parties made a new contract in writing dated November 26, 1939. The applicant for the patents, in this case the plaintiff, assigned all her right, title and interest in the applications and in the patents, when and if issued, to the Company sometime prior to the final execution of the contract of November 26, 1939. In exchange therefor the owner received $3,500 in cash and a "monthly royalty fee of thirty-three and one-third percent (33 1/3) of the invoicing price" of all discs sold separately and a "royalty in the amount of 6% of the invoicing price" of all complete couplings to cover the discs with a fixed minimum of $250.00 per month, for the life of the patents. There was an interval of time elapsed before the papers were finally executed on November 26, 1939, due to the forwarding of the papers between Warren and Washington, where the attorneys were located. The Company paid royalties under this agreement from November 26, 1939 to June 30, 1943. The Corporation was of the opinion that the royalties developed to be

too high and there were negotiations with the owner of the patents that they be reduced. On November 26, 1943, a new written agreement was executed between the plaintiff and the defendant, which recited the agreement of November 26, 1939. Under this agreement the Company reassigned the patents to the owner, and the owner gave to the Company "an exclusive, non-assignable, non-transferable personal license to make, use and/or sell flexible couplings and/or parts thereof * * *". The agreement substituted a new royalty provision "in lieu of the royalty provisions set forth * * * * (in) the said agreement of November 26, 1939, which became effective as of July 1, 1943." It was expressely stipulated that the contract of November 26, 1939, would "remain in full force and effect".

On March 21, 1945, the defendant notified in writing the plaintiff, after voluntarily making the payments, that as of that date no more payments would be made to the plaintiff, and a demand was made that the patents be reassigned to the defendant, together with a return of all royalties paid. The plaintiff, in writing, resisted such a demand, and petitioned this court for a declaratory judgment to determine: whether or not the contracts of November 26, 1939 and of November 26, 1943, are valid subsisting contracts and supported by legal consideration; whether or not royalties have or have not been properly paid under the agreements and whether a return thereof must be made; and whether or not there must be a reassignment of the patents.

The record discloses that this controversy was precipitated by a contest between the Commissioner of Internal Revenue and a taxpayer, and that the United States Tax Court held that the agreements of November 26, 1939 and November 26, 1943, were not supported by legal consideration. The position of that court was that the Company, under the contract of January 6, 1920, and that of March

20, 1920, owned the new patents of December 5, 1939 and of August 8, 1941, and, therefore, any agreement that it may have made to make royalty payments would be doing something that the Company was not bound to do, and, therefore, that such payments would constitute merely a gratuity and not the proper basis for a binding contract.

A preliminary question must be disposed of before a discussion may properly be had of the main controversy. Is the Federal Court bound by the State court in such a case as the one at bar which concerns the interpretation of general contracts? The point is ruled by the case of Blair vs. Commissioners of Internal Revenue, 300 U. S. 5. In that case a question arose as to the validity of an assignment by a beneficiary under a trust of his interest in the trust. This case arose because, if the assignment were valid, then the income tax of the individual would be directly affected. The United States Supreme Court held that the law of the State of Illinois would have to be followed by the Federal court in such cases. The fact that a question of income tax law would be involved as a result of the decision, did not divest the State court of jurisdiction of determining the question before it.

The question then before the court is whether or not the contracts of November 26, 1939 and of November 26, 1943 did or did not have a valid legal consideration. If the plaintiff gave up something of value, and the defendant had something to which it was not previously entitled, as a result of these contracts, then obviously there would be good consideration, as a basis for being legally enforceable contracts.

Assuming that by virtue of the original contract, the defendant was entitled to these patents, without the automotive field rights which were expressly reserved to the plaintiff, then on November 26, 1939 and November 26, 1943, when this plaintiff did bargain away for a stated

consideration this automotive field, as far as it pertained to flexible couplings, was not the defendant receiving something that it did not have before? If it did receive the right to use the patents in the automotive field, is it for the court to say how valuable this right might be? This right may very well be most valuable, but even so, under ordinary contract law, it is not for the court to say how good a deal was made.

There is a second view of the status of these parties and these contracts that are tenable under the pleadings filed. If, in 1929, the parties actually abrogated the contract of 1920, completely, and the parties were not bound by the original agreement, then there is no problem at all. This position is borne out by the language of the parties in their contracts of November 26, 1939 and November 26, 1943, for no mention is made of the original contract at all. On the contrary, just the current situation is given consideration, as a basis for the new contracts. If the parties, in 1929, were relieved of the provisions of the original contract, then certainly it could not be successfully claimed that the defendant on the dates of the new contracts was owner of the patents in any event. There would be a clean slate so far as ownership of the new patents was concerned, and the bargain would then be the basis on a good legal consideration.

Therefore, this court is of the opinion that, under either view, the contracts of November 26, 1939 and of November 26, 1943, are based upon a legal consideration, and, consequently, these contracts are valid and subsisting contracts binding on both the plaintiff and defendant, in accordance with the unambiguous language therein contained.

DECREE

And now, to-wit: this 11th day of July, A. D. 1945, it is hereby ordered, adjudged and decreed:

(1) That the contract of November 26, 1939, between Bertha E. Thomas and Thomas Flexible Coupling Company, providing for the payment of royalties under United States Applications No. 162,205 and No. 289,058, and the supplementary contract thereto dated November 26, 1943, are valid subsisting agreements.

(2) That the aforesaid contracts dated November 26, 1939 and November 26, 1943, are supported by valid, adequate and legal consideration.

(3) That the contracts of November 26, 1939 and November 26, 1943, between the parties, were entered into in good faith and were and are of substantial benefit to the Defendant.

(4) That the Plaintiff was entitled to receive and is entitled to retain the royalties originally paid under the agreement of November 26, 1939.

(5) That the Plaintiff was entitled to receive and is entitled to retain the royalties paid under the supplementary agreement of November 26, 1943.

(6) That the Plaintiff is the present owner of United States Patent 2,182,711, dated December 5, 1939, covered by United States Application No. 162,205 and United States Patent 2,251,722, dated August 5, 1941, covered by Application No. 289,058, together with all rights under pending Application, Serial No. 478,267 filed March 6, 1943.

(7) That Defendant is not entitled to demand or receive reassignments of United States Patents No. 2,182,711 and No. 2,251,722, nor Patent Application, Serial No. 478,267.

(8) That Defendant is indebted to Plaintiff under the agreements of November 26, 1939 and November 26, 1943, for the accrued royalties up to and including May 31, 1945, in the sum of Thirty-four Thousand One Hundred Eighty-three Dollars and Eight Cents ($34,183.08).

(9) That Plaintiff is entitled to receive from the Defendant, under the terms of the agreements of November 26, 1939 and November 26, 1943, royalties accruing thereunder subsequent to May 31, 1945.

(10) That judgment be entered in favor of the Plaintiff and against the Defendant in the sum of Thirty-four Thousand One Hundred Eighty-three Dollars and Eight Cents ($34,183.08).

By the Court,

ALLISON D. WADE,
President Judge.

IV.

FINAL JUDGMENT

July 11, 1945, Judgment is entered in favor of Plaintiff and against Defendant for Thirty-four thousand one hundred eighty-three and 08/100 Dollars, in accordance with Order of Court filed.

ADDISON WHITE,
Prothonotary.

IN THE

Supreme Court of Pennsylvania

EASTERN DISTRICT

BERTHA E. THOMAS *v.* THOMAS FLEXIBLE COUPLING COMPANY, *Appellant*	No. 178 January Term, 1945 Appeal from the Judgment of Common Pleas of Warren County at No. 23, June Term, 1945.

OPINION OF THE COURT

Filed March 25, 1946.

HORACE STERN, J.

Because of a decision of the Tax Court of the United States in passing upon the liability of the defendant company for income and excess profit taxes for the years 1939, 1940 and 1941, a question arose between plaintiff and defendant as to whether certain contacts between them were invalid for want of consideration. Accordingly they joined in asking the Court of Common Pleas of Warren County where the company's plant is situated, for a declaratory judgment in order to resolve that doubt.

Bertha E. Thomas, plaintiff, owned a certain basic patent for flexible couplings, and, on January 6, 1920, submitted a written proposal to defendant that, if it would issue to her 450 shares of its capital stock and would pay her a royalty fee of ten per cent of the total amount of the gross

sales of the couplings during the life of the patent, she would assign the patent (No. 1,325,545) to defendant, reserving to herself, however, the exclusive right under said patent to manufacture and sell flexible couplings for use on motor vehicles; in the event of defendant's increasing its capital stock at any time plaintiff was to be entitled to receive, without further consideration, fifty per cent of such increase. This proposition was accepted by defendant, and, on March 20, 1920, a more formal and comprehensive agreement was executed whereby plaintiff assigned to defendant all her right and interest in two other patents owned by her (Nos. 1,323,423 and 1,326,993), together with all improvements upon the inventions there described, and also all patents on flexible couplings and on future improvements on flexible couplings which might thereafter be granted to her; defendant in turn, granted plaintiff the exclusive right to make and sell, under these patents and subsequent improvements thereon and under any patents owned or to be owned by defendant, flexible couplings to be used in connection with automobiles, trucks and tractors.

Plaintiff received the 450 shares of defendant corporation's stock and also, for the seventeen years' duration of the life of the patent, the ten per cent royalties stipulated in those agreements.

In 1929 the financial condition of the corporation was such that it became necessary for it to raise funds by the sale of additional stock but found itself handicapped in that attempt by plaintiff's right to receive fifty per cent of any such increase. Plaintiff was thereupon induced to enter into an oral agreement whereby defendant was to continue to pay her the ten per cent royalties based on the gross income from its sales of couplings under the patents, but all other provisions of the contracts between them were cancelled and nullified. When the new stock was issued

plaintiff purchased and paid for 50 shares at their par value of $100 per share, and when, after this parol rescission of the agreements, defendant made and sold couplings for use on automotive equipment, plaintiff made no claim to the profits of such sales to which she would otherwise have been entitled under the reservation of her right in that regard in the 1920 contracts.

On September 2, 1937, plaintiff filed an application for a patent for a new and improved flexible coupling. While this application was pending, on January 17, 1939, she made a written proposal to defendant that, in consideration of the sum of $3,500 and the payment to her of a royalty of six per cent of the invoice price of complete couplings sold by the company and of a royalty of 33 1/3 per cent of the invoice price of discs (parts of the couplings) sold separately,—the total royalties to amount to not less than $250 a month and to extend for the life of the patent,—she would assign to defendant the United States and Canadian rights to the application then pending as well as to any other patent for which she might apply up to the time when the then pending application would be granted. This proposition was accepted by defendant, and, on October 26, 1939, while the draft of the agreement to be executed by the parties was still in the course of preparation, she assigned to defendant the exclusive right, for the United States and all foreign countries, to the application filed on September 2, 1937, to another application which she filed on August 8, 1939, for a patent for emergency supports for flexible couplings, and to any patents that might be issued on those applications. On November 26, 1939, the formal contract was executed embodying the terms which had been agreed upon in January. One of its provisions was that plaintiff would assign to defendant "her *entire* title, right and interest in and to all pending applications, patents, or applications which may be filed in the future and in and to any inventions therein set forth which

relate in any way to flexible couplings." Subsequently the patents (Nos. 2,182,711 and 2,251,722) which were granted on the two applications of September 2, 1937, and August 8, 1939, were issued to defendant pursuant to the assignment which plaintiff had executed, and from then on defendant paid plaintiff the royalties provided for in the agreement of November 26, 1939. In June 1943 defendant requested plaintiff to reduce the royalties, and, after several months negotiations, a supplemental contract was entered into on November 26, 1943, which provided that defendant was to assign to plaintiff all of its right, title and interest in and to the patents Nos. 2,182,711 and 2,251,722, and plaintiff, in turn, was to grant to defendant, for the life of those patents, an exclusive license to make and sell flexible couplings thereunder and under an application for another patent which plaintiff had filed on March 6, 1943. In lieu of the royalties provided for in the agreement of November 26, 1939, defendant was to pay to plaintiff, retroactively effective as of July 1, 1943, a royalty of six per cent of the invoice price of all couplings and parts thereof manufactured and sold by it, the maximum royalties in any one year not to exceed $80,000. The provision in the former agreement that plaintiff would assign to the company all applications that she might file in the future relating to flexible couplings was cancelled. Except as thus modified the contract of November 26, 1939, was to remain in full force and effect. The royalties provided for in this 1943 agreement were thereafter paid to plaintiff until March 21, 1945.

The questions raised in the petition for a declaratory judgment are whether the contracts of November 26, 1939 and November 26, 1943, are valid or whether they fail because of lack of consideration; whether plaintiff was entitled to receive and now retain the royalties paid to her under those agreements; whether the patents covered by

those agreements (Nos. 2,182,711 and 2,251,722) belong to defendant by virtue of plaintiff's assignment of October 26, 1939, or to plaintiff under defendant's re-assignment thereof in accordance with the agreement of November 26, 1943; and whether plaintiff is entitled to the royalties that have now accrued and those that will accrue hereafter under the 1943 agreement.

The Tax Court of the United States was of opinion that defendant was entitled by virtue of the agreement of March 20, 1920 to receive from plaintiff an assignment of the two patents here in controversy, and that defendant's agreement to pay royalties on those patents, as provided in the contracts of 1939 and 1943, was without consideration; further, that the patents, having been assigned to defendant on October 26, 1939, were already owned by it at the time the agreement of November 26, 1939, was entered into; also, that plaintiff did not, in the 1939 agreement, abandon any of her rights to the manufacture and sale of flexible couplings for automotive purposes, and that, in any event, such rights were of no value and even their relinquishment, therefore, would not constitute consideration. In the present declaratory judgment proceedings in the court below views exactly contrary to these were adopted and a decree was entered sustaining the rights to the royalties and the patents claimed by plaintiff under the 1939 and 1943 agreements; it is from that decree that the present appeal has been taken.

We are of the opinion—for the reasons following—that the decision of the court below is the correct one.

1. The petition for the declaratory judgment alleges, and defendant's answer admits, that in 1929 the parties orally agreed to cancel the then existing contracts between them, except that defendant was to continue to pay the ten per cent royalties. If such a parol agreement was made it is, of course, legally effective: *Merchants-Citizen Na-*

tional Bank, Executor, v. Mauser, 297 Pa. 399, 404, 147 A. 90, 91; *Magazine Digest Publishing Co. v. Shade,* 330 Pa. 487, 492, 199 A. 190, 193; *Shaffer v. Scharding,* 348 Pa. 423, 35 A. 2d 270. That it was in fact made is evidenced by plaintiff's purchase of some of the stock then issued by defendant instead of obtaining it gratis as was her right under the cancelled contracts; it is evidenced also by her failure at any time thereafter to claim the profits on defendant's manufacture and sale of flexible couplings for use on motor vehicles to which she would have been entitled under those contracts. In any event, we are bound by the allegations of the pleadings which assert that there was such a cancellation, and plaintiff's obligations under the 1920 agreements having thereby ceased, no question of lack of consideration to support the 1939 and 1943 agreements can arise.

2. Even if there had been no parol agreement of cancellation in 1929, the 1920 agreements terminated, in our opinion, with the expiration in 1937 of the life of the patents which constituted their subject matter. It would seem incredible that, in assigning the three original patents to defendant for a royalty fee of ten per cent on the gross sales, and in agreeing to assign all future improvements and all patents that might thereafter be granted to her, the parties contemplated that, after those patents were no longer in force and plaintiff would not be receiving any further royalties therefrom, she would nevertheless remain bound, during the entire balance of her life, to assign to defendant, free of any claim for royalties thereunder, any and all patents for flexible couplings which she might thereafter acquire. What the parties undoubtedly intended was that, *as long as the patents assigned under the* 1920 *contracts remained in force,* defendant was to have the benefit of all improvements thereon invented by plaintiff and of all patents obtained by her; she herself would

profit therefrom by continuing to receive the ten per cent royalties on the sales of the improved couplings. Where there is no express provision in a contract as to its duration the intention of the parties in that regard is to be determined from the surrounding circumstances and by the application of a reasonable construction to the agreement as a whole. Thus considered, it seems to us perfectly clear that the 1920 agreements were not in force when the 1939 agreement was made.

3. Even if, however, the 1920 contracts were still effective when the agreement of 1939 was entered into there was nevertheless a consideration in the latter agreement for defendant's undertaking to pay plaintiff the royalties therein specified because she gave up, in that agreement, her rights in regard to the manufacture and sale of the couplings for automotive use; she contracted to assign to the company her *entire* right, title and interest in and to all of them pending applications and patents and all future applications relating in any way to flexible couplings, thereby relinquishing the rights reserved to her with regard to motor vehicles as specified in the previous contracts. The Tax Court took the position that those rights were not of any value; that finding is negatived by the allegations of the present pleadings, but, in any event, it is an elementary principle that the law will not enter into an inquiry as to the *adequacy* of the consideration: *Hillcrest Foundation, Inc. v. McFeeters,* 332, Pa. 503, 2A.2d. 775, 778.

4. The assignment of patents Nos. 2,182,711 and 2,251,-722 by the instrument dated October 26, 1939, was in pursuance of the agreement of January 17, 1939, and was made in anticipation of the subsequent drafting of the terms agreed upon. The fact that it was delivered a month before the execution of formal contract is, therefore, of no legal significance.

5. As far as the agreement of November 26, 1943, is con-

cerned, it is sufficient to point out that the re-assignment of the patents which defendant there agreed to make was in consideration of a substantial reduction by plaintiff of the royalties specified in the agreement of November 26, 1939. The 1943 agreements was merely a "supplemental" one, and is so characterized in its initial sentence.

The decree and judgment are affirmed, costs to be divided between the parties.

Filed March 25, 1946.

JONES, J. (Dissenting)

The alleged contract between the plaintiff and defendant here involved was before the United States Tax Court on the defendant company's effort to justify, as "ordinary and necessary expenses" of its trade or business, payments made by it to the plaintiff under the contract. The Tax Court found that the contract was without consideration; that the payments made thereunder by the taxpayer (the defendant company) were gratuities; and, that they were therefore not deductible from the defendant's gross income for tax purposes.

I am no more able to find consideration for the alleged contract than was the Tax Court whose findings were by reference expressly incorporated in the plaintiff's petition for a declaratory judgment. Consequently, so far as the merits of the case are concerned, I should reverse the judgment of the court below. But, my further view is that the merits of the case, whatever they may be, never became actionable in this proceeding.

The facts do not present a case for the exercise of the court's declaratory judgment jurisdiction. No actual con-

troversy is pleaded or present. The necessity of such a controversy as the basis for a declaratory judgment proceeding has long been recognized generally. True enough, the requirement was not, in terms, expressly included in our original Declaratory Judgment Act of June 18, 1923, P.L. 840 (12 P.S. ss 831 et seq.). But, in *Kariher's Petition* (No. 1), 284 Pa. 455, 131 A. 265, where the Act was considered and upheld, it was pointed out (p. 471) "* * * that, in all jurisdictions where declaratory judgment practice obtains, the rule is established * * * that jurisdiction will never be assumed unless the tribunal appealed to is satisfied that an actual controversy, or the ripening seeds of one, exists between parties, all of whom are *sui juris* and before the court, and that the declaration sought will be a practical help in ending the controversy: (citing cases) * * *." And, the amendatory Act of April 25, 1935, P.L. 72, expressly made the existence of an "actual controversy" a prerequisite to a court's exercise of declaratory judgment jurisdiction by substituting, inter alia, for Sec. 6 of the Act of 1923 the following,—

> "Relief by declaratory judgment or decree may be granted in all civil cases where an actual controversy exists between contending parties, or where the court is satisfied that antagonistic claims are present between the parties involved which indicate imminent and inevitable litigation, or where in any such case the court is satisfied that a party asserts a legal relation, status, right, or privilege in which he has a concrete interest and that there is a challenge or denial of such asserted relation, status, right, or privilege by an adversary party who also has or asserts a concrete interest therein, and the court is satisfied also that a declaratory judgment or decree will serve to terminate the uncertainty or controversy giving rise to the proceeding."[1]

[1] Sec. 6 of the Declaratory Judgment Act of June 18, 1923, P. L. 840, as amended by the Act of April 25, 1935, P. L. 72, was still further amended by the Act of May 26, 1943, P. L. 645, in a manner not presently material.

There is not now nor has there ever been any controversy between the parties to the record in this proceeding either as to the alleged contract or as to the plaintiff's right to the moneys which she claims thereunder. Throughout the contest over the defendant company's tax liability with the Commissioner of Internal Revenue and before the Tax Court, including the rehearsing granted on the defendant company's petition, the latter at all times asserted and endeavored to maintain the validity of the alleged contract and the plaintiff's rights thereunder as claimed by her. Even in the present proceeding the defendant by its answer sought to make a showing of facts more favorable to the plaintiff's claim than she herself had averred in her petition. There is certainly no controversy between the plaintiff and the defendant with respect to the alleged contract and the rights of the parties thereunder. Yet, that is the entire subject matter of the instant proceeding. The requisites of "an actual controversy" necessary to present a justiciable question cognizable in a declaratory judgment proceeding are not present so far as the rights of the parties to the record are concerned.

As a corporation may dispose of its property as it chooses so long as it does not defraud creditors or violate the rights of stockholders, it was apparent when this appeal was first argued that only creditors and stockholders could possibly be concerned with the effects of what the plaintiff and the defendant had allegedly agreed upon *inter se* and were endeavoring to have this court stamp "Valid." As no creditor was complaining (the record indicated a highly solvent corporation), we set the appeal down for reargument and required the defendant company (a close corporation) to give specific notice to all stockholders of what was involved in the case and inviting them to become parties to the record in this court to voice any objection they might have. The company duly complied with our requirement and the result was a special meeting

of stockholders (with knowledge of the impending reargument and its prescribed prerequisite) at which meeting the stockholders not only approved the alleged contract but also volunteered to give the management a "vote of confidence." Thus, there is manifestly no one with a penny's worth of material interest in the subject matter of this proceeding to contend with anyone else interested materially therein. Consequently, no "actual controversy" exists.

The only controversy there is or has been in this case is the dispute, past and prospective, between the defendant company and the Commissioner of Internal Revenue as to whether payments made by the defendant to the plaintiff under the alleged contract qualify as ordinary and necessary business expenses within the meaning of the Federal Revenue Acts. With that question, we, of course, are not concerned. But, it is counsel's expressed thought that a decision by this court upholding, as a matter of Pennsylvania property law, the alleged contract and the parties' rights thereunder (upon which they are in complete agreement) will be binding upon federal tribunals and that, thereby, the payments made by the defendant to the plaintiff under the alleged contract will become "ordinary and necessary (business) expenses." In my opinion that conception rests upon a misunderstanding of the pertinent law. Incidentally, the rule of *Erie Railroad Co. v. Tompkins,* 304 U.S. 64, 78, which is so strongly stressed in the briefs, has no pertinency whatsoever to an adjudication of a taxpayer's liability under Federal Revenue Acts. Such questions are governed by federal law, uninhibited by state court rulings. Regardless, therefore, of what the status of the alleged contract in the instant case may be under Pennsylvania law, whether the payments made thereunder constitute allowable deductions in ascertaining the defendant company's federal tax liabilities is exclusively a federal

question: see *Commissioner v. Francis E. Tower,* U.S. (decided February 25, 1946). The defendant may be sure that no matter what is done in this case on the basis of state law it will neither hamper nor becloud the Commissioner of Internal Revenue or the Tax Court in correctly identifying the tree which grew the taxable fruits: of *Lucas v. Earl,* 281 U.S. 111, 115.

To paraphrase an apt expression of Mr. Justice Drew in *Kahn v. William Goldman Theatres, Inc.,* 341 Pa. 32, 34, 17 A. 2d 340, all that the parties to the instant proceeding sought was the confirmation of the opinion of their respective attorneys who were in amiable agreement on the matter. They hoped for a court opinion favorable to the plaintiff and for nothing else, substantially an advisory opinion though "* * * such opinions are not contemplated under this legislation": see *Kahn* case, *supra,* at p. 36. In *Taylor v. Haverford Township,* 299 Pa. 402, 406, 149 A 639, this court said that "We are determined that the Declaratory Judgment Act, an excellent piece of legislation when kept within proper bounds, shall not be used in cases to which it is not properly applicable." In my view the benefits of declaratory judgment jurisdiction will best be safeguarded by a strict observance of the caution laid down in the *Taylor* case. As the instant case does not present "an actual controversy," I should reverse the judgment and remand with directions to dismiss the proceeding for want of jurisdiction.

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE THIRD DISTRICT

No. 9005 October Term, 1945

THOMAS FLEXIBLE COUPLING COMPANY,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

Argued April 15, 1946

Before MC LAUGHLIN and O'CONNELL, *Circuit Judges* and GOURLEY, *District Judge.*

OPINION OF THE COURT

(Filed August 20, 1946)

By MCLAUGHLIN, *Circuit Judge.*

Petitioner is a Pennsylvania corporation engaged in the manufacture and sale of flexible couplings. It was organized in 1917. Its president is Millard T. Thomas, who has been in the coupling business since 1914. By January

6, 1920 Bertha E. Thomas, wife of Millard, had secured three patents on flexible couplings. Other than her being named as inventor there is no evidence of any technical knowledge by Mrs. Thomas of flexible couplings. On January 6, 1920 Mr. Thomas owned 325 shares and Mrs. Thomas 25 shares of the 492 shares represented at the stockholders meeting of the corporation held that day. As the result of proceedings at that meeting, on March 20, 1920, an agreement was entered into by the company and Mrs. Thomas. Under it she assigned to the company two of her flexible coupling patents No. 1,323,423 dated December 2, 1919 and No. 1,326,993 dated January 6, 1920 "together with all improvements upon the invention" and "all United States Letters Patents she now owns on flexible couplings and which may be hereafter granted to her and all United States Letters Patents on future improvements on flexible couplings which may be obtained or acquired by her." Mrs. Thomas retained all rights on said patents and improvements in connection with automotive vehicles. Mrs. Thomas on her part received 450 shares of the company stock and royalties of 10% of the gross sales price.

On September 2, 1937 she applied for an improvement patent on flexible couplings which was issued to her December 5, 1939 and numbered 2,182,711. On August 8, 1939 she applied for a patent relating to an emergency support for flexible couplings. This was granted August 8, 1941 and is number 2,251,722. These two inventions were assigned in writing by Mrs. Thomas to the company on October 26, 1939, which assignment was recorded in the Patent Office October 27, 1939. On November 26, 1939, the company and Mrs. Thomas entered into a written contract whereby Mrs. Thomas assigned the last two named patents to the company for $3500, and certain specified royalties. Patents in pursuance of this agreement were thereafter issued the company. Any license to make or sell under the letters patent on flexible couplings to be used in con-

nection with automobiles, trucks and tractors was without value on October 26, 1939 and November 26, 1939. Payments were made to Mrs. Thomas in 1939, 1940 and 1941 under the November 26, 1939 agreement.

The Tax Court held that those payments were not ordinary and necessary business expenses and therefore not deductible from petitioner's gross income. This finding was arrived at because at the time of the November 26, 1939 contract, Mrs. Thomas had already agreed by the March 20, 1920 document to assign to the company all United States letters patent granted her on future improvements on flexible couplings and she had also already assigned in writing to the company on October 26, 1939 the two patents covered by the royalty agreement of November 26, 1939. The two patents were improvements on flexible couplings and the March 20, 1920 contract was determined to have been supported by adequate consideration. The trial consumed three days in New York City and one day in Washington. Petitioner was represented by experienced counsel. The Court concluded that the petitioner was under no legal obligation to pay the royalties and that there was no showing of any exceptional business necessity for making such payments.

Petitioner applied to the Tax Court for rehearing. The main grounds were: (1) Newly discovered evidence that a later oral agreement between Millard acting for the company, and Mrs. Thomas, superseded the written contract of March 20, 1920 which was rescinded. By the terms of the alleged oral contract Mrs. Thomas was no longer obligated to assign to the company any patents which might thereafter be granted to her or any patents on future improvements on flexible couplings. From this the conclusion was drawn that the assignments of the patents in 1939 being therefor assignments to which the company was not already legally entitled, they constituted consideration for

the agreement of the company to pay Mrs. Thomas the disputed royalties. (2). That the assignments of the patents on October 26, 1939 were made in accordance with a contract between the company and Mrs. Thomas in January 1939 with the contract of November 26, 1939 merely a formal confirmation thereof. In that situation it could not be said that petitioner was already the owner of the patents (under the assignment of October 26, 1939) when it contracted to pay the questioned royalties; and (3) Evidence that the license in connection with automobiles, trucks and tractors was not valueless as found by the Court.

The Tax Court passing on the proffer of evidence found the first contention wholly without merit. It observed that Millard Thomas, alleged to have acted for the company in the January 1939 oral agreement with Mrs. Thomas, testified extensively in the hearing with no reference to such a contract, and with his testimony inferentially inconsistent with the existence of such contract. On the third point the Court cited the evidence which caused it to decide that the automotive license was valueless in 1939. In addition thereto it held that by the contracts and assignments of 1939 Mrs. Thomas did not relinquish her license under the March 1920 contract. In view of this the Court held the second point, namely, proof of an alleged contract in January 1939, was immaterial.

Following the denial of rehearing in the Tax Court, there was a declaratory judgment proceeding as to the November 26, 1939 agreement brought in the Warren County, Pennsylvania, Common Pleas Court by Mrs. Thomas against the company. In that matter the company defendant admitted the oral agreement to cancel the contracts with the exception of the continuance of the obligation to pay Mrs. Thomas ten per cent royalties. It also admitted the informal contract of January 1939. The case was heard on complaint and answer. The Common Pleas

Court sustained plaintiff's claims. The Pennsylvania Supreme Court affirmed. Thomas v. Thomas Flexible Coupling Co., 353 Pa. 591 (opinion filed March 25, 1946). Judge Jones in a strong dissenting opinion, noting that the defendant by its answer sought to make a showing of facts more favorable to the plaintiff's claim than she herself had averred in her petition, said, "There is certainly no controversy between the plaintiff and the defendant with respect to the alleged contract and the rights of the parties thereunder." He further pointed out that creditors were not interested in the litigation, the corporation being highly solvent and that stockholders had not only approved the alleged contract but also volunteered to give the management a vote of confidence. He then said, "Thus there is manifestly no one with a penny's worth of material interest in the subject matter of this proceeding to contend with anyone else interested materially therein. Consequently, no 'actual controversy' exists."

The only problem in this case is whether the royalty payments to Mrs. Thomas constituted "ordinary and necessary expenses" of the company. This is not a question of state law under Erie v. Tompkins, 304 U. S. 64, 78. It is entirely an issue of federal tax law. For what it was worth, petitioner's whole case to date has been passed upon by the Tax Court. On the evidence before it in the original hearing it decided against the petitioner. On the rehearing motion it considered the entire offer of the petitioner on the basis that the additional evidence would be as represented, and it concluded that its original finding should remain undisturbed.

The Tax Court obviously labored under no misapprehension of law in its decision. Under the facts before it and passing upon the credibility of the witnesses it found that there was no consideration for the royalty agreement, that the royalty payments by the company were actually

voluntary and that they were not ordinary and necessary business expenses. The contract principles which the Tax Court applied are of course sound Pennsylvania and universal law, but the evidence and particularly the manner of its presentation was far different in the Tax Court than in the Common Pleas. It is unnecessary to repeat the radically changed smooth picture given the state tribunal. From the undisputed facts before it, the Common Pleas, and later the Supreme Court, held that there the royalty agreement was sufficient under the state law. But that finding in no way vitiates the Tax Court decision, solidly based on federal tax law, that the payments were not ordinary and necessary business expenses. That tax law doctrine is the foundation of the United States Supreme Court's opinion in Commissoiner v. Tower, U. S. (February 25, 1946). The partnership issue in that case was urged as valid under Michigan law. There was no collateral state court finding as here, but the Supreme Court had such an element very much in mind, Mr. Justice Black saying in the opinion:

> "Respondent contends that the partnership arrangement here in question would have been valid under Michigan law and argues that the Tax Court should consequently have held it valid for tax purposes also. But the Tax Court in making a final authoritative finding on the question whether this was a real partnership is not governed by how Michigan law night treat the same circumstances for purposes of state law. Thus, Michigan could and might decide that the stock-transfer here was sufficient under state law to pass title to the wife, so that in the event of her death it would pass to whatever members of her family would be entitled to receive it under Michigan's law of descent and distribution. But Michigan cannot by its decisions and laws governing questions over which it has final say, also decide issues of federal tax law and thus hamper the effective enforcement of a valid federal tax levied against earned income."

The Court further said:

"The question here is not simply who actually owned a share of the capital attributed to the wife on the partnership books. A person may be taxed on profits earned from property, where he neither owns nor controls it. Lucas v. Earle, supra. The issue is who earned the income and that issue depends on whether this husband and wife really intended to carry on business as a partnership. Those issues cannot be decided simply by looking at a single step in a complicated transaction. To decide who worked for, otherwise created or controlled the income, all steps in the process of earning the profits must be taken into consideration. See Commissioner v. Court Holding Co., 324 U.S. 331, 334. Of course, the question of legal ownership of the capital purportedly contributed by a wife will frequently throw light on the broader question of whether an alleged partnership is real or pretended. But here the Tax Court's findings were supported by a sufficient number of other factors in the transaction, so that we need not decide whether its holding as to the completeness of the gift was correct. Cf. Helvering v. Hallock, 309 U.S. 106, 117, 118; Burnet v. Wells, 289 U.S. 670, 677."

* * * *

"It is the command of the taxpayer over the income which is the concern of the tax laws. Harrison v. Schaffner, 312 U.S. 579, 581, 582. And income earned by one person is taxable as his, if given to another for the donor's satisfaction. Helvering v. Horst, 311 U.S. 112, 119. It is for this reason, among others, that we said in Helvering v. Clifford, supra, 335, that transactions between husband and wife calculated to reduce family taxes should always be subjected to special scrutiny. For, if under circumstances such as those now before us, the end result of the creation of a husband-wife partnership, though valid under state laws, is that income produced by the husband's efforts continues to be used for the same business and family purposes as before the partnership, failure to tax it as the husband's income would frustrate the purpose of 26 U.S.C. Section 22(a). By the simple ex-

pedient of drawing up papers, single tax earnings cannot be divided into two tax units and surtaxes cannot be thus avoided."

Lusthaus v. Commissioner, U. S. , a companion case to Tower, concerned much the same circumstances as Tower but under Pennsylvania law. In the opinion the Supreme Court quoted the Tax Court's decision below with approval saying: "It concluded that while the partnership was 'clothed in the outer garment of legal respectability' its existence could not be recognized for income tax purposes." We followed those decisions in Commissioner v. Henry, F.2d (June 11, 1946) where we said through Judge O'Connell: "In the last analysis, taxability depends upon application of the Federal criterion."

Petitioner contends that in addition to Erie R. R. v. Tompkins (supra), Blair v. Commissioner, 300 U. S. 5, controls the point before us. The Blair case while not mentioned in Mr. Justice Black's opinion in Tower was certainly considered by the Supreme Court at the time. It is referred to in Mr. Justice Reed's dissent in Lusthaus which was argued with the Tower appeal. It is worthy of attention that Blair v. Commissioner is not cited to uphold the Lusthaus partnership as being valid under Pennsylvania law but for the proposition that the gift to Mrs. Lusthaus "was a gift of property which thereafter produced income which was taxable to the donee as in Blair v. Commissioner, 300 U. S. 5; * * *." In the Blair case the determination of the petitioner's liability rested entirely upon local law. The pertinent decision of the Illinois court was prior to the particular Board of Tax Appeals hearing it; it was considered by the Board and was the sole reason for the Board finding as it did.

As we see it the pending issue is directly within the scope of the Tower and Lusthaus opinions. In Tower, the Supreme Court accepted the possibility of the Michigan

law upholding the stock transfer and thus validating Mrs. Tower's title to the stock but the Court said in effect that such final state conclusion could not govern the question of the federal taxability of the stock to the husband. In Lusthaus the cloak of legal respectability under Pennsylvania law could not be recognized for income tax purposes. Here the Tax Court heard and for all practical purposes reheard the matter and decided the mixed questions of law and fact which arose. Later on, in a suit started after the Tax Court opinions had been filed, the state court upheld the royalty contract on facts agreed between the parties. That decision cannot hamper "the effective enforcement of a valid federal tax levied against earned income." And the decision of the Tax Court under all the circumstances and predicated on the mixed questions of law and fact involved is final. Dobson v. Commissioner, 320 U. S. 489; John Kelley v. Commissioner, U. S. (January 7, 1946).

Petitioner's contention that the Tax Court erred in refusing to grant a rehearing is sufficiently covered in the above discussion. It is without merit as is the final point urged.

Affirmed.

JUDGE O'CONNELL participated in the consideration and decision of this case but was unable to collaborate in the preparation of the opinion.

A true Copy:

Teste:

Clerk of the United States Circuit Court of Appeals for the Third Circuit.